(3)

No. 91-381

Supreme Court, U.S.
FILED
OCT 17 1991
OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

THE PEOPLE OF THE STATE OF ILLINOIS, *ex rel.*, THE OFFICE OF PUBLIC COUNSEL,

Petitioner,

v.

THE ILLINOIS COMMERCE COMMISSION, *et al.*,

Respondents.

Petition for Writ of Certiorari to the Illinois Supreme Court

BRIEF OF RESPONDENTS NORTHERN ILLINOIS GAS COMPANY, ILLINOIS POWER COMPANY, IOWA-ILLINOIS GAS AND ELECTRIC COMPANY, UNITED CITIES GAS COMPANY, MT. CARMEL PUBLIC UTILITY CO., CENTRAL ILLINOIS PUBLIC SERVICE COMPANY, THE PEOPLES GAS LIGHT AND COKE COMPANY, NORTH SHORE GAS COMPANY, AND UNION ELECTRIC COMPANY IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI

STEPHEN J. MATTSON
MICHELE ODORIZZI
Counsel of Record
CHRISTIAN F. BINNIG
MAYER, BROWN & PLATT
190 South LaSalle Street
Chicago, Illinois 60603
(312) 782-0600
Attorneys for Northern Illinois Gas Company and Iowa-Illinois Gas and Electric Company

BRENT E. GALE
ROBERT P. JARED
KAREN M. HUIZENGA
IOWA-ILLINOIS GAS AND ELECTRIC COMPANY
206 East 2nd Street
Davenport, Iowa 52801
(319) 326-7605
Attorneys for Iowa-Illinois Gas and Electric Company

OWEN E. MACBRIDE
FREDERICK J. SPERLING
REBECCA J. LAUER
CARRIE J. HIGHTMAN
SCHIFF HARDIN & WAITE
7200 Sears Tower
Chicago, Illinois 60606
(312) 876-1000
Attorneys for Illinois Power Company

DAVID J. ROSSO
KARL B. ANDERSON
JONES, DAY, REAVIS & POGUE
225 West Washington Street
Chicago, Illinois 60606
(312) 782-3939
Attorneys for Central Illinois Public Service Company

(Additional counsel listed on inside cover)

Midwest Law Printing Co., Chicago 60611, (312) 321-0220

DANIEL J. KUCERA
FRANK A. MRAZ
CHAPMAN AND CUTLER
111 West Monroe Street
Chicago, Illinois 60603
(312) 845-3000
Attorneys for United Cities Gas Company

JAMES HINCHLIFF
GERARD T. FOX
MARK J. MCGUIRE
WILLIAM M. LOPEZ
122 South Michigan Avenue
Suite 320
Chicago, Illinois 60603
(312) 431-4400
Attorneys for The Peoples Gas Light and Coke Company and North Shore Gas Company

ERIC BRAMLET
KOGER & BRAMLET, P.C.
316½ Market Street
Mt. Carmel, Illinois 62863
(618) 263-3502
Attorney for Mt. Carmel Public Utility Co.

RONALD K. EVANS
1901 Chouteau Avenue
St. Louis, Missouri 63166
(314) 621-3222
Attorney for Union Electric Company

Dated: October 17, 1991

QUESTION PRESENTED

In 1988, the Illinois Commerce Commission authorized Illinois utilities to recover from their retail customers 100 percent of certain pipeline charges that the utilities had been required to pay as a result of orders issued by the Federal Energy Regulatory Commission ("FERC"). The Commerce Commission declined to conduct a prudence review of these charges on the ground that it was preempted from doing so by the filed rate doctrine as applied in *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986), and *Mississippi Power & Light Co.* v. *Moore*, 487 U.S. 354 (1988). On appeal, the Illinois Supreme Court affirmed.

The only issue properly presented in this Court is whether the Illinois Supreme Court erred in holding that the Supremacy Clause of the United States Constitution precludes a state commission from conducting a "prudence review" to determine the extent to which interstate pipeline charges that utilities unavoidably incurred as a result of orders issued by the FERC should be allowed in setting retail rates.

STATEMENT PURSUANT TO RULE 29.1

Respondent Northern Illinois Gas Company is a wholly-owned subsidiary of NICOR Inc. It has no subsidiaries other than wholly-owned subsidiaries.

Respondent Iowa-Illinois Gas and Electric Company has no parent company and no subsidiaries other than wholly-owned subsidiaries.

Respondent Illinois Power Company has no parent company. It has the following subsidiaries that are not wholly-owned: Illinois Power Fuel Company and Electric Energy, Inc.

Respondent Central Illinois Public Service Company is a wholly-owned subsidiary of CIPSCO, Inc. It has the following subsidiary that is not wholly-owned: Electric Energy, Inc.

Respondent United Cities Gas Company has no parent company or subsidiaries other than wholly-owned subsidiaries.

Respondent Mt. Carmel Public Utility Company has no parent company and no subsidiaries.

Respondents The Peoples Gas Light and Coke Company and North Shore Gas Company are wholly-owned subsidiaries of Peoples Energy Corporation. Neither respondent has any subsidiaries other than wholly-owned subsidiaries.

Respondent Union Electric Company has no parent company. It has the following subsidiary that is not wholly-owned: Electric Energy, Inc.

TABLE OF CONTENTS

	PAGE
QUESTION PRESENTED	i
STATEMENT PURSUANT TO RULE 29.1	ii
TABLE OF AUTHORITIES	iv
STATEMENT OF THE CASE	1
REASONS FOR DENYING THE WRIT	2
I. THE ILLINOIS SUPREME COURT'S DECISION DOES NOT CONFLICT WITH ANY DECISION OF THIS COURT	9
A. *Nantahala* And *Mississippi Power* Are Squarely Applicable To The Case At Bar	9
B. Petitioner's Attempts To Distinguish This Case From *Nantahala* and *Mississippi Power* Are Unavailing	14
II. THIS CASE INVOLVES THE APPLICATION OF A CLEAR RULE TO PARTICULAR FACTS THAT ARE NOT LIKELY TO RECUR IN THE FUTURE	18
III. THERE IS AN INDEPENDENT STATE LAW BASIS FOR UPHOLDING THE DECISION IN THIS CASE	19
CONCLUSION	21

TABLE OF AUTHORITIES

CASES:	PAGE
American Gas Association v. *FERC*, 912 F.2d 1496 (D.C. Cir. 1990)	17
Arkansas Louisiana Gas Co. v. *Hall*, 453 U.S. 571 (1981)	10
Associated Gas Distributors v. *FERC*, 893 F.2d 349 (D.C. Cir. 1989), *cert. denied*, 111 S.Ct. 277 (1990)	8, 13, 19
California Coastal Comm'n v. *Granite Rock*, 480 U.S. 572 (1987)	16
Capital Cities Cable, Inc. v. *Crisp*, 467 U.S. 691 (1984)	16
Chevron U.S.A. v. *Natural Resources Defense Council*, 467 U.S. 837 (1984)	16
City of Chicago v. *People of Cook County*, 133 Ill. App. 3d 435, 478 N.E. 2d 1369 (1st Dist. 1985)	20
Kentucky West Virginia Gas Co. v. *Pennsylvania Public Util. Comm'n*, 862 F.2d 69 (3d Cir. 1988)	10, 18
Maislin Industries v. *Primary Steel*, 110 S.Ct. 2759 (1990)	17
Mississippi Power & Light Co. v. *Moore*, 487 U.S. 354 (1988)	7, 8, 10, 11, 12, 14, 18
Nantahala Power & Light Co. v. *Thornburg*, 476 U.S. 953 (1986)	7, 9, 10, 11, 12, 14, 18
New Orleans Public Service, Inc. v. *The Council of the City of New Orleans*, 911 F.2d 993 (5th Cir. 1990), *cert. granted*, 111 S.Ct. 1617 (1991)	18, 19
The Peoples Gas Light & Coke Co. v. *Slattery*, 373 Ill. 31, 25 N.E. 2d 482 (1939)	20

No. 91-381

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

THE PEOPLE OF THE STATE OF ILLINOIS, *ex rel.*, THE OFFICE OF PUBLIC COUNSEL,

Petitioner,

v.

THE ILLINOIS COMMERCE COMMISSION, *et al.*,

Respondents.

Petition for Writ of Certiorari to the Illinois Supreme Court

BRIEF OF RESPONDENTS NORTHERN ILLINOIS GAS COMPANY, ILLINOIS POWER COMPANY, IOWA-ILLINOIS GAS AND ELECTRIC COMPANY, UNITED CITIES GAS COMPANY, MT. CARMEL PUBLIC UTILITY CO., CENTRAL ILLINOIS PUBLIC SERVICE COMPANY, THE PEOPLES GAS LIGHT AND COKE COMPANY, NORTH SHORE GAS COMPANY, AND UNION ELECTRIC COMPANY IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI

STATEMENT OF THE CASE

In its opinion, the Illinois Supreme Court described this case as a "classic situation for application of the [filed rate] doctrine, for it involves an intermediary faced with a FERC-set wholesale rate, who would, if the doctrine were not applied, be forced to sell power at less than its rea-

sonable cost as determined by FERC." Petn. at A30. The factual background supporting that conclusion is as follows.

Prior to 1985, the FERC tightly controlled the interstate market for natural gas. Only pipelines sold natural gas on an interstate basis, with the FERC setting both the well-head price paid to gas producers by the pipelines and the wholesale rates pipelines were allowed to charge to "local distribution companies" ("LDCs") like respondents. In the 1970s, FERC-approved well-head prices were often maintained at artificially low levels, making it difficult for pipelines to secure adequate sources of supply. Those difficulties increased during the natural gas shortage of the 1970's. In order to guarantee their sources of supply in this market, virtually all of the interstate pipelines entered into long-term "take-or-pay" contracts with producers. Under those contracts, the pipelines agreed to take a certain amount of gas each year or pay for any gas not taken. *See* R. Vol. IX, Tab 28 at 5-6.

In the late 1970's deregulation began. Under the Natural Gas Policy Act of 1978, well-head prices were gradually deregulated. That deregulation had the effect of encouraging production to the point where a gas surplus developed. Although well-head prices fell as a result of this so-called gas "bubble," LDCs were unable to take advantage of the lower prices because the pipelines that controlled the transportation of gas typically refused to transport gas they themselves did not sell.

In 1985, the FERC responded to this situation by adopting an "open access" transportation policy. Under the open access policy, interstate pipelines were no longer permitted to monopolize natural gas sales. Instead, they were required to offer non-discriminatory access to their pipelines to all entities if they allowed any third party to

transport over their systems. *See* FERC Order No. 436, 50 Fed. Reg. 42408, 33 FERC Statutes and Regulations ¶ 61,007 (Oct. 18, 1985). As a result of this new policy, an LDC could, for the first time, purchase substantial volumes of gas directly from a producer and transport it over an interstate pipeline system, without using the pipeline as a middleman in the sale. Because the open access policy was introduced at a time when there was a natural gas surplus, a strong "spot" market developed in which gas could be purchased directly from producers at unregulated prices that were often far lower than those charged by the pipelines under FERC-approved rates. *See* R. Vol. V at C-01501; Commission Order of November 22, 1988 at 4; R. Vol. IX, Tab 28 at 5-16.

The FERC's open access policy proved to be a boon to consumers. With the strong encouragement of the Illinois Commerce Commission, many Illinois LDCs reduced their gas costs significantly by buying on the spot market. These cost savings were passed on immediately, in their entirety, to the LDCs' customers through the purchased gas adjustment clauses in the LDCs' tariffs.[1]

For the pipelines, however, the FERC's open access policy represented a potential financial disaster. Because their cost of purchasing gas was often locked in at what were now above-market prices by long-term take-or-pay contracts, the pipelines were unable to reduce their prices to meet competition from the spot market. As a result, the pipelines could not sell all of the gas they were required to take or pay for under their contracts with gas

[1] For example, during the period from January 1984 through April 1988, Northern Illinois Gas Company's customers alone saved at least $340 million as a result of spot market purchases. *See* R. Vol. IX, Tab 26 at 9-10; Tab 27 at 14-15; Tab 36; Tab 38.

producers. If they had been held strictly to their contractual obligations to pay for all of the gas they could no longer sell, the pipelines would have owed literally billions of dollars to producers. *See* R. Vol. IX, Tab 28 at 3-16.

For two years, the FERC was silent as to how the take-or-pay crisis would be resolved. Finally, in August 1987, the FERC issued Order No. 500, which established a framework for recovery of costs incurred by pipelines in settling or paying their take-or-pay liabilities. *See* 52 Fed. Reg. 30334 (August 14, 1987). Under Order No. 500, pipelines retained a right to seek full recovery of all of their take-or-pay liabilities in a traditional FERC rate-making proceeding.[2] At the same time, however, the FERC offered a newly-crafted "voluntary" alternative, promising pipelines guaranteed recovery of up to one-half of their take-or-pay costs if they agreed to absorb an equal amount without seeking recovery from the LDCs.

In order to persuade the pipelines to accept the guaranteed recovery alternative, the FERC promised pipelines a new and different recovery mechanism. Instead of adding the take-or-pay costs into the pipelines' current wholesale gas rates, the FERC allowed pipelines that elected the alternative method to bill LDCs directly for their share of the charges in question. These direct-billed costs were allocated by FERC order to all LDCs that had purchased gas from the pipeline during a particular period of time, regardless of whether they continued to do business with the pipeline. The allocation was based on each customer's contribution to the pipeline's decline in sales

---

[2] Under Section 4 of the Natural Gas Act, 15 U.S.C. § 717c, interstate pipelines have a right to recover in their wholesale rates any and all "just and reasonable" costs they "prudently" incurred to purchase gas.

between an historical "base period" (generally before the open access policy went into effect) and an historical "comparison period" (generally a specific period after the open access policy went into effect). Under this "purchase deficiency" method of allocation, LDCs that had taken advantage of the spot market to lower their gas costs were required to bear the brunt of the take-or-pay costs.[3]

By divorcing the take-or-pay recovery mechanism from the pipelines' current wholesale gas prices, the FERC made its guaranteed recovery alternative the only viable economic choice for most pipelines. Pipelines that insisted on claiming full recovery of their take-or-pay costs in a traditional rate-making proceeding faced not only uncertainty as to the amount the FERC would allow them to recover, but also the possibility of large increases in their wholesale rates that would make it difficult, if not impossible, for them to compete in the marketplace for gas sales.[4] On the other hand, pipelines that agreed to absorb

---

[3] For example, assume that a pipeline had three LDC customers. Customer A bought the same amount of gas (100 Mcf per year) from the pipeline in the comparison period as it had in the base period. Customer B reduced its pipeline purchases from 100 Mcf to 75 Mcf per year, and Customer C reduced its pipeline purchases from 100 Mcf to 50 Mcf per year. If the pipeline had $200 in take-or-pay liability and agreed to absorb $100, it would be able to direct bill $100 to its customers. That $100 would be allocated among the LDCs based on each LDC's contribution to the total shortfall of 75 Mcf between the two periods (300 Mcf per year in the base period vs. 225 Mcf per year in the comparison period). Customer A would pay nothing under Order No. 500 because it had not contributed to the shortfall. Customer B would pay ⅓ (25/75) of the $100 and Customer C would pay ⅔ (50/75) of the $100.

[4] Of course, if they were unable to sell a sufficient quantity of gas, pipelines electing the traditional alternative would be unable to recover their take-or-pay costs in fact, even though they were authorized to do so in theory.

up to one-half of their take-or-pay costs would be able to maintain their wholesale prices at competitive levels, while at the same time knowing that they would recover the other half of their take-or-pay costs from LDCs, who were compelled by the FERC to pay the costs directly billed to them.

The vast majority of the pipelines serving Illinois LDCs elected the guaranteed recovery alternative. *See* R. Vol. V at C-01501. By Order dated April 27, 1988, the Illinois Commerce Commission initiated a generic proceeding to determine on what basis the LDCs would be permitted to recover direct-billed take-or-pay costs from their retail customers in Illinois. In November 1988, the Commission issued a final order concluding that it was precluded by the filed rate doctrine from disallowing any portion of the direct-billed costs imposed on the LDCs as a result of Order No. 500 and individual FERC ratemaking proceedings. The Commission therefore authorized Illinois LDCs to file tariffs to recover 100% of their FERC-allocated take-or-pay costs from their customers. *See* R. Vol. V at C-01498 to C-01514.

The Office of Public Counsel ("OPC"), an Illinois consumer advocacy group, appealed to the Illinois Appellate Court, which reversed the Commission's order. In its opinion, the Appellate Court relied heavily on suggestions by the FERC that all segments of the natural gas industry, including the LDCs, should "share" in the cost of discharging take-or-pay liabilities by agreeing to absorb some portion of those costs, rather than passing them along to the next link in the distribution chain. The Appellate Court held that this suggestion was enough to dispel the preemptive effect that the FERC allocation of direct-billed costs ordinarily would have. The Appellate Court then remanded to the Illinois Commerce Commission for an in-

quiry into (1) the "sharing" of take-or-pay costs between LDCs and their ratepayers and (2) the prudence of the past purchasing practices of the LDCs as they related to take-or-pay costs.

On appeal, the Illinois Supreme Court unanimously reversed the Appellate Court's decision, reinstating the Commerce Commission's order. The Supreme Court held that the FERC's suggestions with respect to industry sharing were completely irrelevant. It also held that the take-or-pay costs allocated by the FERC to the LDCs were unavoidable and unforeseeable. Under those circumstances, the Court found no room for an exception to the filed rate doctrine.

REASONS FOR DENYING THE WRIT

This is not a case in which a petition for certiorari should be granted. There is no conflict between the Illinois Supreme Court's decision and any ruling by this Court. On the contrary, as the Illinois Supreme Court stated, this case presents a "classic situation" for application of the filed rate doctrine, as that doctrine has been explained and applied by this Court in *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986), and *Mississippi Power & Light Co.* v. *Moore*, 487 U.S. 354 (1988). OPC's contention that the Illinois Supreme Court improperly ignored the views of a federal agency with respect to preemption dissolves in the face of the clear *congressional* intent, which has repeatedly been recognized by this Court, to preempt precisely the kind of state interference with FERC-allocated costs that OPC would have the Illinois Commerce Commission engage in here.

Because the contours of the filed rate doctrine have been clearly defined by this Court in *Nantahala* and

Mississippi Power, this case involves only the application of a clear rule to a particular set of facts. There is no conflict among the state supreme courts or the lower federal courts about the proper application of the test; indeed, the Illinois Supreme Court is the *only* appellate court that has to date addressed the application of the filed rate doctrine to take-or-pay costs allocated to LDCs by the FERC. And, because the FERC's allocation method was struck down in 1989 by the District of Columbia Circuit in *Associated Gas Distributors* v. *FERC*, 893 F.2d 349 (D.C. Cir. 1989), *cert. denied*, 111 S.Ct. 277 (1990), it is unlikely that the same fact pattern will be repeated again in subsequent cases.

In addition to all of these factors, there is an independent state law ground to support the decision below. In the Illinois Supreme Court, respondents argued that the Illinois Commerce Commission had already found the purchasing decisions that later resulted in allocations of take-or-pay costs to be "prudent," in orders that had long since become final. Respondents argued that there was no basis under Illinois law to reopen those decisions in order to conduct a hindsight review of the "prudence" of the purchasing decisions that ultimately led to imposition of those costs. Although the Illinois Supreme Court did not rule on this specific issue, it did agree with respondents that the take-or-pay costs were unforeseeable and that consequently there was no logical basis for conducting any type of prudence review.

I. The Illinois Supreme Court's Decision Does Not Conflict With Any Decision By This Court.

A. *Nantahala* and *Mississippi Power* Are Squarely Applicable To The Case At Bar.

When Congress enacted the Federal Power Act and the Natural Gas Act, it set up a system for regulating energy prices that contained an inherent potential for conflict. With federal agencies regulating wholesale prices and individual state agencies regulating retail prices, there was always the possibility that LDCs might be whip-sawed by conflicts between state and federal regulators, being required to pay a particular price by FERC, but not being able to recover that cost in full from their customers because a state regulator considered the price unreasonable.

In *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986), this Court held that Congress had intended to eliminate any possibility of such a conflict by giving the FERC exclusive and plenary jurisdiction over wholesale utility rates. That means that once the FERC decides that a wholesale price is a reasonable price for a pipeline to charge, a state regulatory commission must accept the fact that it is also a reasonable price for an LDC to pay. A state commission cannot "trap" costs at the state level that have been judged reasonable by the FERC by refusing to permit a utility to recover them in full in its retail rates:

> "The filed rate doctrine ensures that sellers of wholesale power governed by FERC can recover the costs incurred by their payment of just and reasonable FERC-set rates. When FERC sets a rate between a seller of power and a wholesaler-as-buyer, a State may not exercise its undoubted jurisdiction over retail rates to prevent the wholesaler-as-seller from recover-

> ing the costs of paying the FERC-approved rate. . . . Such a trapping of costs is prohibited." 476 U.S. at 970.

In *Mississippi Power & Light Co.* v. *Moore*, 487 U.S. 354 (1988), this Court extended the rationale of *Nantahala*, holding that the prohibition on reconsideration of FERC allocation decisions at the state level could not be evaded through use of a "prudence" review.[5] At issue in *Mississippi Power* was a FERC allocation of a nuclear power plant's capacity costs among several electric utilities that had joined together to construct the plant. The Mississippi Supreme Court held that one of the utilities, MP&L, could not recover all of the capacity costs allocated to it by the FERC on the ground that the Mississippi Public Service Commission was first required to examine the prudence of the management decisions that led to MP&L's participation in the construction of the plant. On appeal, this Court reversed, holding that a prudence review by state regulators was preempted under the Supremacy Clause. In reaching this result, the Supreme Court expressly reaffirmed its decision in *Nantahala*:

> "Our decision in *Nantahala* relied on fundamental principles concerning the pre-emptive impact of federal jurisdiction over wholesale rates on state regulation. First, FERC has exclusive authority to determine the reasonableness of wholesale rates. . . . Second, FERC's exclusive jurisdiction applies not only to rates, but also to power allocations that affect

---

[5] Although *Nantahala* and *Mississippi Power* were decided under the Federal Power Act rather than the Natural Gas Act, the two statutes " 'are in all material respects substantially identical,' and decisions interpreting them may be cited interchangeably." *Kentucky West Virginia Gas Co.* v. *Pennsylvania Public Util. Comm'n*, 862 F.2d 69, 74 n. 8 (3d Cir. 1988), citing *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 577 n.7 (1981).

> wholesale rates. *Id.* at 966. Third, *States may not bar regulated utilities from passing through to retail consumers FERC-mandated wholesale rates.* . . . These principles led us to hold in *Nantahala* that the North Carolina Utilities Commission's order "trapping" federally mandated costs was pre-empted. Today they compel us to hold that the MPSC may not enter an order "trapping" the costs MP&L is mandated to pay under the FERC order allocating Grand Gulf power or undertake a "prudence" review for the purpose of deciding whether to enter such an order." 487 U.S. at 371-72 (emphasis added).

The Court observed that a state prudence review may be appropriate where the LDC had a choice as to whether or not to incur such costs. Thus, if the FERC had approved both high and low cost power rates by two different wholesale suppliers, a state commission could properly consider a utility's prudence if it decided to purchase the higher cost power. However, the Court held that a state prudence review is necessarily preempted where the utility has no legal right to avoid the costs in question:

> "As we assumed [in *Nantahala*], it might well be unreasonable for a utility to purchase unnecessary quantities of high cost power, even at FERC-approved rates, if it had the legal right to refuse to buy that power. But if the integrity of FERC regulation is to be preserved, it obviously cannot be unreasonable for MP&L to procure the particular quantity of high-priced Grand Gulf power that FERC has ordered it to pay for. Just as Nantahala had no legal right to obtain any more low cost TVA power than the amount allocated by FERC, it is equally clear that MP&L may not pay for less Grand Gulf power than the amount allocated by FERC." 487 U.S. at 373-74.

As the Illinois Supreme Court observed, this case presents a "classic situation" for application of the filed rate doctrine set forth in *Nantahala* and *Mississippi Power.*

The LDCs here are indistinguishable from the example cited in *Nantahala* of "a middleman [who] faces a FERC-fixed wholesale rate charged by a power supplier." In that situation, a state agency setting retail rates simply cannot ignore the FERC-mandated costs the middleman must pay:

> "In that situation, for a state ratemaking agency to disregard a FERC-filed rate would clearly be inconsistent with the exclusive federal regulatory scheme over interstate wholesale power prices. The FERC-approved rate at which the middleman purchased power would not be fully recognized as a cost in the retail market, thereby forcing the middleman to sell power at less than its reasonable cost as determined by the federal agency." 476 U.S. at 969.

Moreover, as in *Mississippi Power*, there is no basis for invoking an exception to the filed rate doctrine in order to permit the state to conduct a prudence review. Like the capacity costs at issue in *Mississippi Power*, the FERC-allocated costs at issue here were completely unavoidable by the LDCs. Under orders issued by the FERC, the LDCs were liable to the pipelines for those costs regardless of any action they might take, even if they completely stopped purchasing gas from the pipeline imposing the charge.

In addition to being presently unavoidable, the take-or-pay costs were completely unforeseeable. In the court below, OPC suggested that the Illinois Commerce Commission could properly consider the prudence of the LDCs' past decisions to buy from particular pipelines. The Illinois Supreme Court rejected that argument, on the ground that the LDCs did not know and could not have foreseen that their purchasing decisions would lead to the retroactive imposition of direct-billed take-or-pay costs years later. Until Order No. 436 was issued in 1985, no one

knew that long-term take-or-pay contracts would create multi-billion dollar liabilities for the pipelines.[6] And it was not until Order No. 500 was issued in 1987 that the LDCs had any idea whether or how the pipelines' take-or-pay liabilities would be passed on to them. By that time, the purchasing decisions OPC would have the Illinois Commerce Commission review for prudence had long since been made. Thus, as the Illinois Supreme Court recognized, "unless clairvoyance has become an element of prudence, there simply is no basis on which the ICC could conduct a meaningful prudence review." Petn. A31.

The Illinois Supreme Court's determination that there was no basis for a "meaningful prudence review" of direct-billed take-or-pay costs is essentially a finding of fact that this Court need not and should not reconsider. That is particularly true in light of the similar finding by the District of Columbia Circuit. In *Associated Gas Distributors* v. *FERC*, 893 F.2d 349, 356 (D.C. Cir. 1989), *cert. denied*, 111 S.Ct. 277 (1990), the FERC tried to persuade the D.C. Circuit that the purchase deficiency method of allocation did not constitute retroactive rate-making because it had provided advance notice to the LDCs of its intention to use that method in 1984. The court rejected that argument, describing the supposed "hints" the FERC pointed to in a 1984 order as "delphic" and stating that "[t]he Commission can perhaps assume that petitioners [pipelines and LDCs] have some acquaintance with regulatory changes

[6] Prior to the advent of open access in 1985, the only way (with very limited exceptions) LDCs could obtain natural gas was by purchasing from the interstate pipelines serving their areas. For many LDCs that meant there was no choice at all, since they were physically limited to a single pipeline source for either all or a significant portion of their service territories.

in the natural gas industry, but it cannot require them to be clairvoyant." *Id.*

Nantahala and *Mississippi Power* together set forth a bright line test as to how the filed rate doctrine applies to ratemaking decisions by state utility commissions. In this case, the Illinois Supreme Court applied that test properly to the specific facts before it. OPC has not offered any reason in its Petition why this Court should review that decision.

B. Petitioner's Attempts To Distinguish This Case From *Nantahala* And *Mississippi Power* Are Unavailing.

In an attempt to avoid the applicability of *Nantahala* and *Mississippi Power*, OPC argues that the "gas liabilities" at issue here are "purely intrastate in nature" and therefore do not fall under the filed rate doctrine. Petn. at 27-28. *See also* Petn. at 18 ("Take-or-pay liabilities are not FERC-approved allocations of costs or FERC-mandated payments.") This argument is mystifying at best. The pipelines directly billed take-or-pay costs to the LDCs pursuant to mandatory FERC allocations of those costs. Respondents could not avoid paying these FERC-allocated costs. Under these circumstances, it would be difficult to imagine wholesale costs that are more clearly interstate pipeline costs imposed by the FERC. The fact that the Illinois Commerce Commission was setting retail rates within Illinois under which the LDCs would be allowed to recover those FERC-allocated costs does not change the analysis. Indeed, the filed rate doctrine is specifically designed to limit the power of state commissions to fix intrastate retail rates when the state's action would prevent utilities like LDCs from fully recovering all of the costs they are required to pay by FERC orders.

OPC also attempts to evade the filed rate doctrine by arguing that it cannot apply in light of the FERC's suggestion that the LDCs should absorb some portion of the take-or-pay costs allocated to them in order to participate in an industry-wide "sharing" of those costs. At page 34 of its Petition, OPC incorrectly asserts that respondents misled the Illinois Supreme Court with respect to the FERC's intent by suggesting, OPC says, that "it was not clear whether FERC indicated a desire to preempt." In fact, however, the LDCs made the FERC's position absolutely clear to the Illinois Supreme Court, which also had the benefit of all the FERC orders issued on the subject.[7] The Illinois Supreme Court's decision was not based on any misreading or misunderstanding of the FERC's intent. Instead, it was based on the Court's determination that the FERC's intent was wholly irrelevant. That determination was plainly correct.

A federal agency's intent with respect to the preemptive effect of its actions is relevant only in cases where (1) there is no congressional intent to preempt state ac-

[7] In briefs filed in the Illinois Supreme Court, respondents explained at length the FERC's Order No. 500-H, which was issued on December 13, 1989. *See* 54 Fed. Reg. 52344, FERC Statutes and Regulations ¶ 30,867. In that Order, the FERC reiterated the view it had expressed in Order No. 500 that there should be an "equitable" industry-wide sharing of the cost of discharging the pipelines' take-or-pay liabilities. The FERC also made clear its belief that the LDCs should be forced to "share" by absorbing a portion of those costs rather than passing them on to gas consumers. The FERC suggested various methods that state regulators could use to deny full recovery to LDCs. It also suggested that state regulators could use the same carrot-and-stick approach that the FERC had used with the pipelines: using the delay associated with prudence hearings and the threat of an unfavorable recovery method to persuade the LDCs to "agree" to absorb a portion of the costs in return for guaranteed recovery of the rest.

tion in a particular area *and* (2) the proposed state regulation does not in fact conflict with federal regulation.[8] Where Congress acts to make federal jurisdiction over a particular subject matter exclusive, the intent of the agency when it exercises that jurisdiction is wholly beside the point. As this Court stated in *Chevron U.S.A.* v. *Natural Resources Defense Council*, 467 U.S. 837, 842-43 (1984), "[i]f the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." Similarly, where a federal agency has promulgated regulations, it cannot dispense with the Supremacy Clause merely by saying that it believes inconsistent state regulation is permissible. *See generally Capital Cities Cable, Inc.* v. *Crisp*, 467 U.S. 691, 699 (1984).

In this case, if the FERC had chosen to exercise its exclusive jurisdiction over interstate pipeline charges by allowing take-or-pay costs to be included in the price of gas *currently* being sold, state utility commissions could have determined whether LDCs that subsequently elected to purchase gas at prices that included a take-or-pay component had acted prudently in choosing among whatever supply alternatives were available to them. But when the FERC decided instead to eliminate any element of choice by *allocating* take-or-pay costs directly to individual LDCs

---

[8] OPC relies on this Court's decision in *California Coastal Comm'n* v. *Granite Rock*, 480 U.S. 572 (1987), to support its contention that the FERC's views on preemption are controlling. That case, however, involved a situation very different than the case at bar, because Congress did *not* intend in that case to give the federal agency exclusive jurisdiction over the issue in question (environmental regulation of mining in a national forest) and the agency's own regulations assumed that the state would have a role in the permit process.

based on their *past* purchases, it necessarily destroyed the ability of state utility commissions to consider whether those costs had been prudently incurred.

In short, the Illinois Supreme Court was correct in considering what the FERC *did*, rather than what it said, in determining the preemptive effect of the FERC's allocation of direct-billed take-or-pay costs to the LDCs. Contrary to the argument advanced by OPC, the FERC has no power to waive the preemptive effect it created by the direct allocation of take-or-pay costs to the LDCs, even if the FERC viewed preemption as an obstacle to the proper resolution of the problems created by its own open-access policy.[9]

As this Court held in *Maislin Industries* v. *Primary Steel*, 110 S.Ct. 2759, 2770 (1990), even though a federal agency that is charged with regulating a particular industry segment "has both the authority and expertise generally to adopt new policies when faced with new developments in the industry . . . it does not have the power to adopt a policy that directly conflicts with its governing statute." (citation omitted). In this case, the Natural Gas Act protects LDCs from inconsistent state and federal regulation by prohibiting state utility commissions from

---

[9] Significantly, the FERC itself never purported in any of its orders to be making a binding pronouncement on the preemption issue. Indeed, when Order No. 500 was appealed to the District of Columbia Circuit, the FERC specifically stated that it had merely been making suggestions, rather than making a reviewable agency determination with respect to preemption. *See American Gas Association* v. *FERC*, 912 F.2d 1496, 1520 (D.C. Cir. 1990), where the court accepted the FERC's explanation for its statements and concluded that it lacked jurisdiction to review the FERC's position because the only possible injury to the LDCs was that "state agencies might defer excessively" to it.

second-guessing the reasonableness of costs that the FERC has directly ordered the LDCs to pay. The FERC has no power to withdraw that protection in order to implement a solution that it deems "equitable."

II. This Case Involves The Application Of A Clear Rule To Particular Facts That Are Not Likely To Recur In The Future.

There are a variety of reasons why this is not a cert-worthy case. As demonstrated above, the Illinois Supreme Court properly followed this Court's decisions in *Nantahala* and *Mississippi Power*. Moreover, those decisions set forth a clear and unambiguous framework to be used in defining the scope of a state utility commission's power with respect to FERC-approved wholesale rates and allocations. The clarity of the framework established by this Court is confirmed by the fact that there are no conflicts among state supreme courts or in the lower federal courts concerning application of the test set forth in *Nantahala* and *Mississippi Power*.[10]

---

[10] Significantly, OPC does not argue that there is any such conflict. In *Kentucky West Virginia Gas Co.* v. *Pennsylvania Public Util. Comm'n*, 862 F.2d 69, 74 (3rd Cir. 1988), the Third Circuit reached the same result as the Illinois Supreme Court did here, holding that under the filed rate doctrine an LDC was entitled to recover the full amount of certain "minimum bill" costs similar to take-or-pay costs, because those costs were unavoidable and had been imposed pursuant to a FERC-approved service agreement. In *New Orleans Public Service, Inc.* v. *The Council of the City of New Orleans*, 911 F.2d 993 (5th Cir. 1990), *cert. granted*, 111 S.Ct. 1617 (1991) ("*NOPSI*"), the Fifth Circuit held that a prudence review could proceed with respect to certain nuclear power plant costs. However, that decision was based on the court's determination that there was some basis for conducting a meaningful pru-

(Footnote continued on following page)

Thus, this case involves simply another application of a clear rule to a particular set of facts. This Court has no reason to inquire into the Illinois Supreme Court's characterization of those facts. That is particularly true since the precise fact pattern involved here is unlikely to arise in subsequent cases. While this case was on appeal, the District of Columbia Court of Appeals struck down the "purchase deficiency" method of allocating take-or-pay costs on the ground that it constituted prohibited retroactive rate-making. *Associated Gas Distributors* v. *FERC*, 893 F.2d 349 (D.C. Cir. 1989), *cert. denied*, 111 S.Ct. 277 (1990). As a result, any cases that may come to the Court in the future concerning recovery of take-or-pay costs at the retail level are likely to involve different facts and therefore may involve different issues as well.[11]

When all of these factors are considered, it is apparent that this is simply not the kind of case this Court should devote its limited resources to reviewing.

III. There Is An Independent State Law Basis For Upholding The Decision In This Case.

In the courts below, respondents argued that Illinois law provided an independent ground for affirming the Illinois Commerce Commission's order. The LDCs argued that there

---

[10] *continued*
dence review of the utility's decision to incur the costs in question. Given the directly contrary finding under very different facts by the Illinois Supreme Court in this case, *NOPSI* is readily distinguishable. Furthermore, although this Court has granted the utility's petition for a writ of certiorari in *NOPSI* and is scheduled to hear argument this Term, the parties have indicated that the case may well be settled before argument.

[11] We are not aware of any appellate court cases in other jurisdictions that were decided under the FERC's old method of allocation.

was no basis under Illinois law for requiring them to "share" some arbitrary portion of take-or-pay costs. Under Illinois law, in order to disallow a cost, the Commission must have a basis for deciding that it was improperly incurred.[12] See *The Peoples Gas Light & Coke Co.* v. *Slattery*, 373 Ill. 31, 61-62, 25 N.E. 2d 482, 497 (1939); *City of Chicago* v. *People of Cook County*, 133 Ill. App. 3d 435, 442-443, 478 N.E. 2d 1369, 1374-75 (1st Dist. 1985). Thus, the only basis under Illinois law for disallowing take-or-pay costs would be through a prudence review.

In the court below, the LDCs argued that any prudence review of take-or-pay costs would necessarily be meaningless. Because they could not have predicted that the FERC would ultimately deal with take-or-pay costs as it did, the LDCs could hardly be faulted for failing to take the FERC's 1987 decision into account when they made their purchases during the "comparison periods" of 1983 through 1986. The Illinois Commerce Commission had already found the purchasing decisions made during those years to be prudent, in final orders that were no longer appealable, on the basis of the information available at the time the purchasing decisions were made. The LDCs argued that there was no basis under state law for reopening those decisions many years later for a prudence review by hindsight.

Although the Illinois Supreme Court found it unnecessary to rule on the LDCs' state law arguments in light

---

[12] The same standard applies to rate-making decisions by the FERC. Indeed, the reason why the FERC went to such great lengths to encourage pipelines to absorb their share of take-or-pay costs "voluntarily" was that it could not legally require them to do so except by finding that those costs were not prudently incurred.

of its disposition of the federal preemption claim (Petn. at A32), its opinion nevertheless indicates strong sympathy for the LDCs' position with respect to Illinois law. The Court agreed with the LDCs that the allocation of take-or-pay costs under the purchase deficiency method was unforeseeable and therefore that there was simply no basis for a meaningful prudence review by the Illinois Commerce Commission. Thus, even though the Illinois Supreme Court did not rule on the specific issue raised by respondents, its opinion suggests that there would be serious state law issues that would have to be resolved before OPC would be entitled to the relief it has requested, even if OPC were correct on the federal constitutional issue. The existence of this independent state ground to support the ruling below provides yet another reason why this Court should deny OPC's Petition.

CONCLUSION

For the foregoing reasons, the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

STEPHEN J. MATTSON
MICHELE ODORIZZI
Counsel of Record
CHRISTIAN F. BINNIG
MAYER, BROWN & PLATT
190 South LaSalle Street
Chicago, Illinois 60603
(312) 782-0600
Attorneys for Northern Illinois Gas Company and Iowa-Illinois Gas and Electric Company

OWEN E. MACBRIDE
FREDERICK J. SPERLING
REBECCA J. LAUER
CARRIE J. HIGHTMAN
SCHIFF HARDIN & WAITE
7200 Sears Tower
Chicago, Illinois 60606
(312) 876-1000
Attorneys for Illinois Power Company

(Additional counsel listed on following page)

BRENT E. GALE
ROBERT P. JARED
KAREN M. HUIZENGA
IOWA-ILLINOIS GAS AND ELECTRIC COMPANY
206 East 2nd Street
Davenport, Iowa 52801
(319) 326-7605
Attorneys for Iowa-Illinois Gas and Electric Company

DANIEL J. KUCERA
FRANK A. MRAZ
CHAPMAN AND CUTLER
111 West Monroe Street
Chicago, Illinois 60603
(312) 845-3000
Attorneys for United Cities Gas Company

JAMES HINCHLIFF
GERARD T. FOX
MARK J. MCGUIRE
WILLIAM M. LOPEZ
122 South Michigan Avenue
Suite 320
Chicago, Illinois 60603
(312) 431-4400
Attorneys for The Peoples Gas Light and Coke Company and North Shore Gas Company

DAVID J. ROSSO
KARL B. ANDERSON
JONES, DAY, REAVIS & POGUE
225 West Washington Street
Chicago, Illinois 60606
(312) 782-3939
Attorneys for Central Illinois Public Service Company

ERIC BRAMLET
KOGER & BRAMLET, P.C.
316½ Market Street
Mt. Carmel, Illinois 62863
(618) 263-3502
Attorney for Mt. Carmel Public Utility Co.

RONALD K. EVANS
1901 Chouteau Avenue
St. Louis, Missouri 63166
(314) 621-3222
Attorney for Union Electric Company

Dated: October 17, 1991